

**MINUTES
REGULAR MEETING
ARIZONA STATE RETIREMENT SYSTEM BOARD**

**Friday, October 21, 2005
8:30 a.m., MST**

The Arizona State Retirement System (ASRS) Board met in the 10th Floor Board Room, 3300 N. Central Avenue, Phoenix, Arizona. Dr. Keith Meredith, Chair of the ASRS Board, called the meeting to order at 8:45 a.m., MST.

The meeting was teleconferenced to the ASRS office at 7660 E. Broadway, Tucson, Arizona 85710.

1. Call to Order; Roll Call; Opening Remarks

Present: Dr. Keith Meredith, Chair
Mr. Karl Polen, Vice Chair
Mr. David Byers
Mr. Jaime Gutierrez
Mr. Chris Harris (via teleconference)
Mr. Michael Townsend (via teleconference)
Mr. Lawrence Trachtenberg
Mr. Steven Zeman

Absent: Ms. Anne Mariucci

A quorum was present for the purpose of conducting business.

2. Approval of the Consent Agenda

2D(i) – J.W. Brantley – Mr. J.W. Brantley appeared telephonically to address the Board regarding his appeal. Mr. Brantley explained that he was not given fair consideration in his long term disability application and he felt discriminated against. Mr. Brantley stated that the ASRS made their decision about his case with incomplete information. Dr. Meredith asked for questions for Mr. Brantley from the Board members and there were none.

2D(ii) – Ronald J. Kriloff – Mr. Ronald J. Kriloff appeared before the Board regarding his appeal. Mr. Kriloff explained that he has found himself in a very difficult situation due to incorrect information provided to him from Mesa Unified School District (Mesa USD). He was retired for two days when he applied to work for Mesa USD as a bus driver. He informed them

of his retirement and was told it wasn't a problem. After approximately three years of employment, an ASRS audit of Mesa USD revealed that Mr. Kriloff had worked twenty or more hours for twenty or more weeks which is in violation of the 20/20 rule. Mr. Kriloff explained that he never would have worked for an ASRS employer if he knew his retirement would be in jeopardy. The Board had no questions for Mr. Kriloff.

Motion: Mr. Karl Polen moved to approve Refunds, Death Benefits and Retirements,

And

Approve the System Transfers,

And

Approve the minutes of the September 16, 2005 Regular Meeting of the ASRS Board,

And

Approve the Recommended Administrative Law Judge's Decision Regarding:

- i. J.W. Brantley
- ii. Ronald J. Kriloff

Mr. Steven Zeman seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved.

3. Presentation, Discussion and Appropriate Action Regarding Coconino County's New Medicare Advantage Plan

Mr. Paul Matson, Director explained that the ASRS is in the process of implementing an HMO type network in Coconino County and an ASRS member, Dr. Dan Julien, requested that an agenda item be placed on the Board agenda to discuss this plan.

Dr. Dan Julien addressed the Board on behalf of the Northern Arizona University Retirees Association (NAURA) due to concerns about the HMO plan that will be effective January 1, 2006. Dr. Julien asked that the temporary rural subsidy be continued until a viable Health Maintenance Organization (HMO) is available in Coconino County. Dr. Julien explained that the proposed plan that will be effective January 1, 2006 is lacking for several reasons. Dr. Julien explained that the number of doctors seems insufficient, the cost increase to remain in currently offered plans is too much, many of the doctors listed as available aren't accepting new patients, and the access to doctors for those retirees living in rural parts of Arizona will be too limited.

Dr. David Whorton, NAURA member, voiced similar concerns regarding the proposed HMO.

Mr. Pat Klein, Assistant Director, External Affairs, and Mr. Dan Cadriel, Pacificare, addressed these various issues and indicated that there were sufficient doctors available to Coconino County residents. Many doctors may have stated they aren't accepting new patients presently,

but these doctors will be accepting new patients as of January 1, 2006. Mr. Klein also explained that because of a similar plan that the Arizona Department of Administration (ADOA) will be putting into effect on January 1, 2006, certain Coconino County residents will lose the rural subsidy regardless of what the ASRS does. The rural subsidy is only in place for Medicare eligible retirees if there is not an HMO available.

Mr. Karl Polen asked if it was possible to extend open enrollment so that members would have more time to choose their plan. Mr. Klein responded that even though open enrollment ends October 28, member enrollment forms are still accepted through the first cut-off in December. This is a practice that is done every year. Mr. Dave Byers also voiced that because of the special concerns of the senior population and potentially serious implications for them in switching doctors, extending the open enrollment date is a good idea. Members of the Board agreed that because of the special circumstances this year, the deadline extension needs to be made more public and more official. Mr. Byers asked that this item be revisited at the December Board meeting.

Dr. Julien addressed the board a final time and brought up the issue of the definition of an HMO. Dr. Julien disagrees that the impending actions of the ADOA will affect the Rural Subsidy because he doesn't agree that they will be offering programs that qualify as HMOs. Mr. Tom McClory, Assistant Attorney General, explained that according to state statute, a service area exists if a person is eligible to participate in a health care service organization other than a PPO or an indemnity plan. The Board has the authority to determine if the people have available to them a health service organization other than a PPO or an indemnity plan. This would determine if the Rural Health Care Subsidy would need to continue.

Staff indicated that they would extend the open enrollment date in a more public manner. The Board took no action but will revisit this issue at a future Board meeting.

4. Presentation, Discussion and Appropriate Action Regarding Notice of Proposed Rulemaking for R2-8-115, Return of Contributions Upon Termination of Membership by Separation from Service by Other than Retirement or Death; Payment of Survivor Benefits Upon the Death of a Member

Mr. Jaime Gutierrez, Chair, External Affairs Committee, called on Ms. Nancy Johnson, Rules Coordinator, to discuss the proposed rulemaking. Ms. Johnson stated that the rulemaking will amend R2-8-115 which concerns the return of contributions to non-retired members who no longer work for an ASRS employer. The amendment will remove a time requirement of 21 days before contributions are returned to the member and in its place require that any employer who has made contributions must certify that the employee is terminated and at that time has no intent to re-hire them. This rulemaking is a part of a larger plan to make it easier for members to get contributions back in a timelier manner.

Motion: Mr. Jaime Gutierrez moved to approve the proposed rulemaking for R2-8-115, return of contributions upon termination of membership by separation from service by other than retirement or death; payment of survivor benefits upon the death of a member,

Mr. David Byers seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved.

5. Presentation, Discussion and Appropriate Action Regarding Possible Legislation for the 2006 Legislative Session

Mr. Jaime Gutierrez, Chair, External Affairs Committee (EAC), informed the Board that the legislative session will begin in January and there are a number of ASRS legislative initiatives that will be brought before the Board.

Ms. Denisse Gee, Government Relations Officer, presented information regarding several issues and following general discussion two items were separated for further discussion: the proposed legislation regarding changes to the refund of employer contributions to non-retired members and legislation regarding changes to the pop-up/pop-down benefit for post-2001 members.

Motion: Mr. Gutierrez moved to approve the public policy initiative to repeal statutory language that deals with the modified deferred retirement option program,

And

Approve the public policy initiative to modify the current investment manager qualification requirements, to remove the requirement that an eligible investment manager have at least three years of experience handling institutional investments of at least \$250 million dollars,

And

Approve the public policy initiative to clarify statutory language regarding employer retirement incentive programs,

And

Approve the public policy initiative to modify statutory language regarding the ASRS long-term disability program, specifically addressing LTD benefit offsets and pre-existing condition limitations,

And

Approve the public policy initiative to provide ASRS with the option to use the AHCCCS provider network for retiree healthcare with AHCCCS concurrence,

And

Approve the public policy initiative to change the rate by which interest is accrued on survivor benefits to allow the Board the flexibility to set the interest rate in conformity with other rates that the ASRS accrues,

And

Approve the public policy initiative to give the ASRS the specific statutory authority to allow an ASRS member who has chosen the period certain annuity option to name a beneficiary,

And

Approve the public policy initiative to conform state statute to IRS regulations governing the minimum distribution rules contained in Section 401 (a)(9) of the Internal Revenue Code of 1986,

And

Approve the public policy initiative to conform state statute to federal law for the purpose of calculating “compensation” for an employee who is ordered into or volunteers for active military service,

Mr. Chris Harris seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved.

Dr. Robert Letson addressed the Board regarding the motion to change the pop-up/pop-down benefit. Dr. Letson stated that the Board’s responsibility is to act in the best interest of the beneficiaries and maintaining the current pop-up/pop-down will be in the best interest.

The legislative initiative regarding changes to the refund of employer contributions to non-retired members presented two options for the Trustees:

Option One: Eliminate the ability of a non-retired member who is hired on or after the enactment date of this statutory change to receive any employer contributions when leaving ASRS membership.

Option Two: Eliminate the ability of a non-retired member who is hired on or after the enactment date of this statutory change to receive any employer contributions when leaving ASRS membership, and, allow a non-retired member who was hired before the enactment date of this statutory change to receive employer contributions refunds based on the amount of service time the non-retired member has accrued as of June 30, 2007.

General discussion among the Trustees determined that more information and more time for discussion was needed to make a decision regarding this change to the refund of employer contributions to non-retired members. Ms. Denisse Gee and Mr. Patrick Klein informed the Board that they could move to open a folder regarding the issue so as not to miss out on this Legislative session, and then move forward with specific statutory language when a Board decision is eventually made.

Motion: Mr. Chris Harris moved to open a folder in the general topic of changes to the refund of employer contributions to non-retired members.

Mr. Jaime Gutierrez seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved.

Mr. Karl Polen left the meeting.

Motion: Mr. Jaime Gutierrez moved to open a folder in the general topic of changes to the pop-up/pop-down benefit for post-2001 members.

Mr. Steve Zeman seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, and 2 excused, the motion was approved.

6. Presentation, Discussion and Appropriate Action Regarding Open Meeting Law

Dr. Keith Meredith stated that Agenda Item 6 would be postponed until a future Board meeting.

7. Presentation, Discussion and Appropriate Action Regarding the ASRS Global Tactical Asset Allocation (GTAA) Program

Mr. Gary Dokes, Chief Investment Officer (CIO), stated that in March, 1984, the ASRS' U.S. tactical asset allocation account was started and invested in a Barclays Global Investors static mix portfolio, 60% equities/40% fixed income. The strategy allowed BGI to move tactically between their S&P 500 and U.S. Debt index funds based upon their view of relative value between U.S. stocks and bonds.

In 2002, IMD/Mercer recommended that the mandate be broadened from a domestic TAA strategy to a global TAA (GTAA) strategy. GTAA seeks to add value through asset allocation (U.S. Equity, Non-U.S. Equity, U.S. Fixed Income, and Non-U.S. Fixed Income), country selection (equity and fixed income), and currency selection. Following an extensive GTAA manager search that occurred in 2003, the Board approved the Investment Committee (IC) recommendation to hire Goldman Sachs Asset Management and Bridgewater Associates as GTAA managers.

As of September 30, 2005, the total market value of the ASRS GTAA managers was 2.4 billion, or 10.6% of the ASRS total fund. For both GTAA managers, the inception date is December 31, 2003 and each have a benchmark of 56% S&P 500/28% Lehman Aggregate/16% MSCI EAFE.

The performance for the GTAA managers has improved significantly during the past year. For the one-year period ending September 30, 2005, Bridgewater and Goldman Sachs have outperformed the benchmark by 2.4% and 2.6%, respectively.

8. Presentation, Discussion and Appropriate Action Regarding the ASRS Real Estate Asset Class

Mr. Dokes informed the Board that as part of the ASRS asset allocation policy adopted in 2003, the Board approved a 6% strategic allocation to institutional real estate. As a result, the ASRS hired Courtland Partners as the ASRS real estate consultant, and an Investment Management Division (IMD) Real Estate Portfolio Manager responsible for the development of a comprehensive ASRS Real Estate Program Plan document. The Plan was subsequently approved by the Board; the implementation of the Plan began soon thereafter. Implementation activities have included, but are not limited to, the development of the required process and program infrastructure in addition to the selection and/or funding of nine real estate managers which includes one internally-managed REIT portfolio.

In addition, the ASRS owns three real estate properties in Arizona. Two of the properties are the existing buildings that ASRS partially occupies, and one is a vacant parcel in which the ASRS has a 50% joint venture interest. The 3300 Office Tower building and adjacent vacant joint venture land are located in Phoenix, and the Broadway Proper office building is located in Tucson.

9. Presentation, Discussion and Appropriate Action Regarding the ASRS Investment Principles

Mr. Paul Matson stated that it is important for the ASRS, when making investment decisions, to function within a set paradigm. There is a need for macro-oriented investment principles to provide a framework for decision making. As part of the April 23, 2005, ASRS Investment Strategic Analysis Session, the IC, Board Chair and ASRS Senior Management discussed a list of past investment goals as well as other relevant investment priorities. As the result of these discussions, and follow-up input from the Board Chair, IC Chair, Director, CIO, and others, a proposed list of investment principles has been developed.

Motion: Mr. Larry Trachtenberg moved to replace the current ASRS Investment Goals with the four ASRS Principles as follows:

1. Maximize the fund rate of return for an acceptable level of fund risk.
2. Achieve a long-term fund rate of return equal to or greater than the actuarial assumed interest rate.
3. Mitigate employee and employer contribution rate volatility.
4. Achieve a long-term economic and actuarial funded status of approximately 100%.

By adopting these principles, the current five ASRS Investment Goals are eliminated to be replaced by goals to be developed based on the four principles.

Mr. Chris Harris seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, and 2 excused, the motion was approved.

10. Presentation, Discussion and Appropriate Action Regarding the Schedule for Meetings of the Arizona State Retirement System Board for the Calendar Year 2006

Dr. Meredith stated that the Board meetings for calendar year 2006 will follow the same format as calendar year 2005. Board meetings will occur the third Friday of the month and there will be no meetings in January or June.

Proposed Board meeting schedule for calendar year 2006:

February 17, 2006, Friday, 8:30 a.m.	August 18, 2006, Friday, 8:30 a.m.
March 17, 2006, Friday, 8:30 a.m.	September 15, 2006, Friday, 8:30 a.m.
April 21, 2006, Friday, 8:30 a.m.	October 20, 2006, Friday, 8:30 a.m.
May 19, 2006, Friday, 8:30 a.m.	November 17, 2006, Friday, 8:30 a.m.
July 21, 2006, Friday, 8:30 a.m.	December 15, 2006, Friday, 8:30 a.m.

Motion: Mr. Steve Zeman moved to approve the ASRS Board meeting schedule for calendar year 2006.

Mr. Lawrence Trachtenberg seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, and 2 excused, the motion was approved.

11. Director's Report

Mr. Matson stated that he and Mr. Anthony Guarino, Deputy Director, Chief Operations Officer, are working on the Strategic Plan which will be presented to the Board in December. This report will include goals and objectives for investments as well as operations.

Regarding the compliance report, there were zero errors for the internal investment validation report and the refunds report. The service purchase report stated three errors, two of which were more substantial. All of the errors have been remedied.

12. Possible Presentation and Discussion Regarding Board Committee Updates

Mr. Jaime Gutierrez, Chair, External Affairs Committee, reported that similar activity as discussed earlier in the Board meeting is expected as the legislative session approaches.

Mr. Lawrence Trachtenberg, Chair, Investment Committee, reported that the next Investment Committee meeting will be October 31, 2005. Topic of discussion will be determining a mid-cap growth manager to recommend to the Board.

Mr. Michael Townsend, Chair, Operations Committee, reported that at the previous Operations Committee meeting there was a detailed review of the IT plan.

13. Board Requests for Agenda Items

Dr. Meredith stated that there will be follow up at a future Board meeting to the Coconino County Rural Subsidy issue as discussed earlier in the meeting.

14. Call to the Public

No members of the public requested to speak.

15. The next ASRS Board meeting is scheduled for Friday, November 18, 2005 at 8:30 a.m., at 3300 N. Central Avenue, 10th Floor Board room, Phoenix, Arizona.

16. Adjournment of the ASRS Board

Dr. Meredith adjourned the October 21, 2005 Board meeting at 12:07 p.m.

ARIZONA STATE RETIREMENT SYSTEM

Anne Schrode, Secretary

Date

Paul Matson, Director

Date